COUNTY OF LOS ANGELES
TREASURER AND TAX COLLECTOR
KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET, ROOM 432
LOS ANGELES, CA 90012
TELEPHONE: (213) 974-2101 FAX: (213) 626-1812

MARK J. SALADINO
TREASURER AND TAX COLLECTOR

June 23, 2003

TO: Supervisor Yvonne Brathwaite Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: Mark J. Saladino
Treasurer and Tax Collector

SUBJECT: **2003-2004 TAX AND REVENUE ANTICIPATION NOTES**

As I reported to you on June 9, 2003, all three rating agencies confirmed the highest short-term ratings for this transaction; however, their written reports have only recently been released. Copies of each of the rating agency reports are attached for your information.

In addition, there were no changes made to our long-term ratings at this time, despite continuing concerns about the restructuring of the Department of Health Services and the potential fallout from the State's fiscal problems. While the rating agencies acknowledge the significant progress the Board has made in restructuring health service care in this County, they also note that the recent court challenges along with declining federal support will continue to be a sizeable challenge.

A copy of 2003-2004 Official Statement for this transaction is also being provided to comply with federal tax securities regulations. If you have questions regarding this information, please contact me or your staff may contact Deborah Lindholm of my office at 974-7175.

MJS:DL
dtl:trans:04 rating memo to bos

Attachments

c: Executive Officer, Board of Supervisors
Chief Administrative Officer
Auditor-Controller
County Counsel

Fitch Rates Los Angeles County, California $600MM TRANs 'F1+'

Fitch Ratings-San Francisco-June 10, 2003: Los Angeles County, California's $600,000,000 2003-2004 tax and revenue anticipation notes, series A are rated 'F1+' by Fitch Ratings. The notes were sold through negotiation by a syndicate led by Lehman Brothers yesterday. The notes are dated July 1, 2003 and mature June 30, 2004.

Fitch's highest rating for short-term debt reflects the sound note repayment structure, strong coverage of all note repayment set-asides, and the availability of substantial borrowable resources throughout the fiscal year. The repayment deposit structure sets aside 100% of principal and interest two months in advance of note maturity. The county's long-term credit quality also is a rating factor, marked by a moderate recessionary impact and satisfactory year-end reserves, although financial operations remain narrowly balanced and fiscal pressures continue. Long-term credit considerations focus on the county's challenge in reforming its financially draining health care system and the state's sizable budget deficit.

The notes are secured by a first lien on unrestricted revenue in fiscal 2004. Pledged revenue is projected to total $4.6 billion for fiscal 2004, covering note principal and interest 7.5 times (x). Funds for repay will be set-aside based on an aggressive schedule beginning in December 2003. By Jan. 31, 2004 more than one-half of the estimated principal and interest due will be impounded; the full amount will be set-aside by April 30. The projected cash flow covers all five set-asides well, ranging from 2.4x-7.3x. Also, the county has a substantial pool of resources available for the intrafund loans, with month-end balances in these funds ranging from $645 million-$2.5 billion over the last three years. The fiscal 2004 cash flow projects ending the year with a moderate cash balance ($394.2 million). Historically the county's actual ending balance has been higher than original forecasts. However, the cash flow is based on the county's proposed budget, which by necessity incorporates significant uncertainty regarding state funding and related programs.

The projected general fund cash flow is based on Los Angeles County's proposed fiscal 2004 budget, which is under review by the Board of Supervisors. Like fiscal 2003, the budget begins with an initial operating deficit. The $432 million general fund fiscal gap is moderate at 3.7% of the budget's $11.8 million in spending, and is closed primarily with staff position reductions and accumulated reserves. Overall, the county's full budget is a 3.5% reduction from this year, reflecting lower staffing in all departments, expected to be achieved through attrition and eliminating vacant positions. Reserves, while reduced, are maintained at prudent levels. Adhering to the budget's austere spending plan will require strong fiscal discipline. Also, the budget includes no salary or benefit increases for county workers; most labor agreements have expired or will expire during the upcoming fiscal year.

The county's health and hospital system also begins with a budget gap, $372 million, with dramatic actions taken to solve the imbalance. Additional measures will be necessary to avoid deficits in the future. Revenues are enhanced by county voters' approval of Measure B, a parcel tax dedicated to emergency and trauma medical care. However, the measures taken and under consideration to reduce spending throughout the system, while reflecting the board's determination to bring the sizable network under fiscal control, have encountered active opposition and litigation. Achieving self-sufficiency for the system will take continued diligence over several years.

Overall, Los Angeles County has made significant progress toward long-term financial stability as evidenced by consecutive operating surpluses and sound year-end general fund balances. Nonetheless, the county continues to face challenges in bringing ongoing spending in line with recurring revenue. Of particular concern is the county's health department and hospitals. While achieving fiscal balance and avoiding sizable projected deficits in the system is aided by Measure B funds, sizable spending reductions still are needed, and will require service level declines. The county's federal Medicaid demonstration project, also know as the 1115 waiver, has been extended, acknowledging progress in converting inpatient hospital care to outpatient services. The extension continues to provide additional federal funds, but reduces the amount each year. Meeting the county's health care needs within the available and recurring resources will continue to be a sizable challenge, and a key component of credit quality.

Contact: Amy S. Doppelt +1-415-732-5612, San Francisco.

STANDARD & POOR'S

PUBLIC FINANCE

Publication date: 09-Jun-2003
Reprinted from RatingsDirect

Los Angeles County, California; Tax Secured, Note

Credit Analyst: Gabriel Petek, San Francisco (1) 415-371-5042; David G Hitchcock, New York (1) 212-438-2022; Parry Young, New York (1) 212-438-2120

Credit Profile
$600 mil 2003-2004 TRANs ser A dtd 07/01/2003 due 06/30/2004
SP-1+
Sale date: 09-JUN-2003

Rationale

The 'SP-1+' rating On Los Angeles County, Calif.'s TRANs reflects:

- The county's underlying general creditworthiness (GO rating 'A+'),
- A note structure that includes early set-asides of TRAN repayment amounts, and
- Strong overall debt service coverage by net general fund cash balances and other cash resources.

Los Angeles County, Calif.'s TRANs are secured by a first lien on lawfully available taxes, income, revenues, and other unrestricted money received by the county and attributable to fiscal 2004. The county is not authorized to levy a tax for the repayment of the notes. The county must set aside $209 million for note repayment from its first unrestricted money after Dec. 20, 2003; $109 million after Jan. 1, 2004; $68 million after Feb. 1, 2004; $73 million in March 2004, and $156 million plus accrued interest after April 20, 2004.

Coverage by net general fund cash balances alone at fiscal year-end 2003 is projected to be strong at 1.64x, consistent with the very high cash coverage of recent years. The county's past few years of cash flow projections have, in fact, proven conservative. The county's actual cash coverage of previous issuances of $600 million of 2001-2002 cash flow notes and $600 million of 2002-2003 TRANs was 1.88x and 1.80x, respectively, higher than projected cash coverages of 1.75x and 1.29x at the time the 2002 and 2003 TRANs were sold. In addition to general fund cash coverage, the county has access to significant other internal cash sources if general fund revenues do not meet projections. Including these resources, coverage at maturity rises to a very strong 2.10x. These additional sources include a variety of other funds of the county, including the tax collector's trust fund and a departmental trust fund, held outside the general fund.

General fund cash coverage could be affected by cutbacks in state aid, but with projected internally borrowable funds, it should remain sufficient to support the 'SP-1+' rating, even without further county budget adjustments. In May, California Gov. Gray Davis announced revisions to his proposed budget for fiscal 2004 that will result in a scaled back net negative impact to Los Angeles County of about $271 million, compared to a negative impact of $598.6 million as proposed in the governor's initial budget proposal (in January 2003). In addition to the general fund, TRAN security is enhanced due to the county's projection of approximately $900 million in internally borrowable cash from non-general fund money, in addition to $394.2 million of projected general fund cash for the period ending June 30, 2003. In addition, the county is planning further cuts in its revised budget proposal to reduce the effect of anticipated state aid reductions.

The county invests its operating money and TRAN repayment amounts in the county pooled investment fund. As of April 30, 2003, the pool had a book value of $14.82 billion and a market value of $14.84 billion; the pool is highly liquid, with an average maturity of 286 days. As for composition of investments, 57.4% of the pool was, as of April 30, invested in U.S. government and agency obligations, 29.34% in CP, 9.95% in CDs, and 2.31% in corporate notes. About 92.02% of the pool's participants are mandatory participants.

Los Angeles County's financial position has stabilized following the effects of the recession earlier in the 1990s and revenue shifts by the state. County property tax valuations increased 6.8% in fiscal 2003, and other county revenues have remained strong, while economic indicators remain bright for southern California. The county ended fiscal 2000 with an unreserved general GAAP fund balance of $1.15 billion (or 11% of expenditures), up significantly from the $141.6 million balance recorded in fiscal 1998. Fiscal 2001 ended with an additional increase in the unreserved GAAP general fund balance to $796.2 million, or 7.9% of expenditures. Fiscal 2002 ended with a $775.3 million general fund cash balance, a slight increase from $765.8 million of cash held at the start of the year, and above the county's original cash projections. The county's 2003 cash projection is for a draw down to $538 million. The current proposed fiscal 2004 general county budget expects to draw down general county reserves on a budgetary basis of accounting by $144 million on a budget of $14.5 billion. The county is projecting that it is subject up to $189 million in potential impact if the state eliminates the vehicle license fee (VLF) backfill and a three month lag occurs between when the VLF is increased and when the county begins collecting the increased revenue.

County health system budget impact.
Some long-term credit risks remain, particularly from a scheduled phase out of Medicaid waivers and the possibility that welfare caseloads may reverse their recent favorable trends. Currently, the county's 2002-2003 health services department budget totals $4.87 billion, an increase of $498 million over the 2002 budget. The increases are related to previously adopted salary increases and the department's share of $13.9 million as part of the multi-year plan to reduce county's reliance on the Los Angeles County Employees Retirement Association. Overall the health system faced a $377 million deficit projected for 2003-2004, equivalent to 7% of the county budget. The deficit was projected to grow to $762 million by 2006. New funding in the form of a voter-approved parcel tax was approved in November 2002 which will generate $140 million per year for the county hospital trauma system. In addition, the county received $50 million in one-time funding related to the settlement of a lawsuit related to outpatient Medi-Cal rates, $50 million in supplemental Medi-Cal inpatient payments in fiscals 2003 and 2004, and $100 million in funding over two years from the state's selective provider contracting program waiver. Based on this new funding, revised projections show the health department's cumulative deficit not occurring until 2006-2007 (versus 2003-2004). Nonetheless, the cumulative deficit for 2006-2007 is currently estimated at $265 million and growing to $649.4 million in 2007-

2008.

The health department developed a redesign plan to restructure the county's budget. The first phase of the county's plan includes the closure of 16 clinics, reassignmentof the High Desert Hospital as an outpatient clinic, the closure of the Rancho Los Amigos National Rehabilitation Hospital, and the reduction of 100 beds at the LAC+USC Medical Center effective July 1. Although the county board of supervisors approved the plan in 2002, in March 2003 the U.S. District Court-Central District of California issued a preliminary injunction that enjoined the county from closing Rancho (or from reducing service reductions that are covered by Medicaid) or from implementing the 100-bed reduction at the LAC+USC Medical Center.

Outlook

N. M.

Published by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc. Executive offices: 1221 Avenue of the Americas, New York, NY 10020. Editorial offices: 55 Water Street, New York, NY 10041. Subscriber services: (1) 212-438-7280.

Global Credit Research
New Issue
19 JUN 2003

Moody's Investors Service

New Issue: Los Angeles (County of) CA

MOODY'S ASSIGNS MIG-1 RATING TO TAX AND REVENUE ANTICIPATION NOTES OF LOS ANGELES COUNTY, CALIFORNIA

$600 MILLION IN SHORT TERM DEBT AFFECTED

County
CA

Moody's Rating

ISSUE	RATING
2003-04 Tax and Revenue Anticipation Notes Series A	MIG 1
Sale Amount $600,000,000	
Expected Sale Date 06/19/03	
Rating Description Tax and Revenue Anticipation Notes	

Opinion

NEW YORK, Jun 19, 2003 -- Moody's Investors Service has assigned a MIG 1 rating to Los Angeles County's $600 million issue of 2003-04 Tax and Revenue Anticipation Notes Series A. The notes are being issued to fund the County's mid-year cash flow needs and are secured by a pledge of unrestricted, fiscal 2004 general fund receipts. The rating reflects the County's stable financial position, a proposed budget which conservatively reflects uncertainties associated with the State budget by not including an unreasonable growth assumption, and the board's demonstrated willingness to make significant program cuts when necessary to maintain balanced operations. It also reflects the financial position of the State of California, which, while substantially weakened, is not expected to significantly affect the County's TRAN repayment capacity. The County's total liquidity is a strength reflected in the note rating, even adjusting for the County's more expansive definition of borrowable resources than used by most counties. The County still faces a number of notable long-term challenges, particularly in the health department, but these do not affect the credit quality of its note issue for the upcoming fiscal year. The County's general obligation bonds are rated Aa3. Its pension bonds are rated A1, its fixed asset lease obligations are rated A2, and its equipment lease obligations are rated A3

COUNTY'S GENERAL FUND AND OVERALL LIQUIDITY ARE SATISFACTORY AND CONTINUE TO BE MUCH IMPROVED OVER PRIOR YEARS.

After an extended period of year-end cash surpluses in its general fund, in 2003, the County is projecting to end the fiscal year with an operating cash deficit of $237 million. However, the currently projected 2003 ending cash balance of $546 million is $343 million higher than the original projection of $195 million, because the County's cash position at the beginning of 2003 was much higher then originally projected. To some degree, in 2003 the County continued to draw down cash, which had not been expended in 2002. Despite the draw-down, the 2003 ending cash balance still represents 4.1% of receipts, which is a more comfortable cash position than what the County has experienced through much of recent memory. The County's overall financial position at the end of 2003 is expected to be essentially unchanged from the previous year. The overall general fund balance is not expected to vary significantly from the previous year's $1.52 billion. Within this balance we believe that approximately $720 million represents reserves of varying degrees of availability, which affords the County ample operating flexibility.

Cash flow projections show that the County expects a $144 million reduction in its cash position in 2004, with a year-end cash balance of $394 million or 3.0% of receipts. This projection appears reasonable, although it reflects an increase of 1.1% in receipts but only a 0.4% increase in expenditures. The small increase in expenditures is consistent with the budget, which includes sizable reductions. The County's locally generated revenues have increased substantially in recent years, but the County's projections reflect more modest rates of growth. Property taxes are projected to grow by 4.7% in 2004, while in 2003 they grew by 5.2 %. With the expected decrease in state revenues, the County's budget includes a reduction of 2,158 full time positions. Correspondingly, the County's 2004 Cash flows show 0.5% decrease in welfare warrants, only a 1.0% increase in salaries and benefits and a 0.4% increase in services and supplies. While portions of these increases reflect growth in the County's locally generated revenues, the overall projected increase in expenditures is conservative and consistent with the County's historic pattern. Each year the County's actual cash flow outperforms original projections and we expect similar results for 2004. While an actual decrease in ending cash balance is likely, we believe the final balance will be higher than the projected balance of $394 million. But it is noted that the County's cash position continues to be highly dependent on state actions, most significantly the timeliness of certain health care reimbursements (SB855 and SB1255 payments) made by the state to the County. However the County's cash flows reflect very conservative assumptions regarding the timing of such receipts.

The amount of money available for interfund borrowing remains ample. This has improved significantly in recent years primarily due to the implementation by the County, in fiscal 1998, of a commercial paper program to provide construction financing for capital projects. Prior to the implementation of the commercial paper program, the County funded construction with internal borrowings executed through the sale of bond anticipation notes to the County's pooled investment fund. This practice reduced the amount of borrowable resources available to meet the County's cash flow needs. For the end of fiscal 2004, the County estimates that gross funds available for interfund borrowing will be $675 million. Combined with the projected cash balance in the general fund, total available liquidity should equal $1.069 billion or 8.1% of cash receipts.

All California counties face a significant challenge this year in forecasting their cash flows, as the majority of their revenues derive from the State which is projecting a sizable budget deficit in fiscal 2004. The ultimate composition of the State's budget remains unclear. Therefore, all California County cash flow forecasts will all incorporate a substantial amount of uncertainty. While potential effects of the State's fiscal condition could have significant budgetary implications, Moody's believes the County will take appropriate corrective action once the nature and magnitude of the impact becomes clear.

The County estimates approximately a $230 million impact from Governor's May proposals, most of which the County believes it can address by program reductions or eliminations. We believe that any remaining revenue reductions would be minimal and easily absorbed with the use of reserves and cost reductions.

SIGNIFICANT LONG TERM CHALLENGES REMAIN, BUT DO NOT AFFECT SHORT-TERM RATINGS.

The County faces many long-term challenges, which continue to affect its long-term ratings, and which need to be addressed in future years' budgets. Most significantly, the health system's budget depends on one-time revenues and reserves. The County is taking concrete steps toward addressing these problems. In addition to significant savings through substantial cutbacks in 2003, the 2004 budget reflects continued implementation of the health system's redesign plan resulting in $175 million in savings. The budget also includes substantial use of reserves to offset loss of 1115 Waiver revenues and cost increases. The proposed health system budget reflects a net decrease of 642 positions. However it does not reflect two significant new sources of revenue which significantly improve the system's long term financial outlook. The new revenues include voter approved Measure B special tax revenue for trauma centers and additional funding from State's selective provider waiver. While significant cost reductions and new revenue sources improve the health system's financial outlook, legal challenges to some of the department's service cutbacks continue to cloud the department's progress toward structural balance.

KEY STATISTICS

Projected Amount Borrowed as % of Receipts, FY 2004: 4.6%

Actual Ending Cash as % of Receipts, FY 2002: 6.3%

Projected Ending Cash as % of Receipts, FY 2003: 4.1%

Projected Ending Cash as % of Receipts, FY 2000: 3.0%

Historical Minimum Audit Cash as % of Revenue, FY 2000-02: 3.8%

Alternate Liquidity (Estimated 6/30/04): $ 675 million

Alternate Liquidity % of FY 2003 Receipts: 5.1%

Pledged Set-Aside timing (months before June): 4.2 months

Analysts

Kevork Khrimian
Analyst
Public Finance Group
Moody's Investors Service

Eric Hoffmann
Backup Analyst
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653